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C O N F I D E N T I A L ALMATY 003075

SIPDIS

DEPT FOR EB/ESC
EUR/SNEC (MANN)
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E.O. 12958: DECL: 08/21/2015
TAGS: EPET IN KZ CA CH ECONOMIC
SUBJECT: PETROKAZAKHSTAN SOLD TO CHINESE CNPC SUBSIDIARY

REF: ALMATY 1433

Classified By: POEC CHIEF DEBORAH MENNUTI, REASONS 1.4(B) and (D)

¶1. (C) Summary: Canadian oil company PetroKazakhstan (PK) announced its sale to PetroChina, a wholly-owned subsidiary of the China National Petroleum Company (CNPC), on August 22, for $4.18 billion. Thomas Dvorak, president of one of two principal Kazakhstan-based PK operating companies, was optimistic that PK shareholders would approve the sale, while noting that a successful deal hinged on the yet-unknown Government of Kazakhstan (GOK) reaction. A successful sale could bring relief to PK's troubles in the Kazakhstani courts, which include both anti-monopoly charges against the company and criminal charges against Dvorak and other senior executives. End Summary.

Chinese to Pay a 24% Premium

¶2. (U) PK provided details of the sale in an August 22 news release, noting that the $4.18 billion offer constituted a bid of $55 per share, or a 24.4% premium over recent PK stock prices. The transaction will be subject to the approval of two-thirds of PK's shareholders, and is expected to close in October 2005.

Company President Upbeat About Sale

¶3. (C) Thomas Dvorak, president of Kumkol Resources, one of two principal PK operating companies, told Econoff that he was guardedly optimistic about the sale. He anticipated that PK shareholders would approve the deal, noting that the "premium" to be paid by the Chinese was somewhat exaggerated due to the recent fall in PK share prices over recent PK legal troubles with the GOK. Dvorak resisted suggesting that the Chinese had overpaid for PK, noting that CNPC was acquiring an intact company, rather than pieces of one. Furthermore, PK's oil field in the Turgai basin was of particular value to the Chinese, as a source of oil for Atasu-Alashankou pipeline (reftel).

¶4. (C) Less clear to Dvorak was whether the GOK supported the sale -- something which would be known from the GOK's public statements in the coming days. Nor did Dvorak exclude the possibility that the company would be split up, with the Turgai assets going to Lukoil, PK's refinery to KMG, and Kumkol remaining with the Chinese. (Note: Respected trade journal Argus Energy Consultants reported such a deal two weeks ago, and one PK employee thought it likely. End Note.)

¶5. (C) Dvorak added that a successful sale might cause his legal problems to abate. GOK opposition, on the other hand, could make his problems worse. (Note: in 2003 the Kazakhstani Agency for Regulation of Monopolies charged seven PK distribution companies with colluding to raise oil product prices, and in April 2004 criminal charges were brought against Dvorak and PK VP and CFO Clayton Clift for alleged violations of the antimonopoly law. In June 2005, another executive, Daniel Herrmann, was criminally charged with "illegal entrepreneurship" for allegedly violating the terms of a PK drilling permit. Details on Herrman's trial septel. PK has also been hard-hit by GOK enforcement of anti-flaring regulations, suffering a recent drop in production of nearly 20 percent. End Note.)

¶6. (C) If the GOK does not approve of the deal, it might invoke the December 2004 preemption law to block the sale. While PK's lawyers -- and many others -- believe the preemption law would not apply, MEMR and KMG have stated privately that it does and could be enacted in any deal wherein a controlling interest is purchased on the open market in a third country.

¶7. (C) Comment: The sale of PK to the Chinese makes sense on a number of levels. First, the GOK wants to keep China happy, but also wants to keep them from offshore blocks, like Kashagan. A KMG source told us that the Chinese had demanded an offshore bloc in return for supporting a GOK scheme to

build a natural gas pipeline across Kazakhstan from West to East. While not offshore, PK may just be enough to keep the

Chinese happy and secure support for the gas pipeline. Second, as Dvorak noted, PK's Kumkol fields are ideally located to supply the Chinese pipeline. The wild-card here is Russia. The GOK has supported Lukoil in the Russian company's dirty fight with PK over the Turgai joint-venture. If the PK-CNPC deal was done without the GOK's blessing and turns out to harm Lukoil's interests, expect PK's travails to continue. If, on the other hand, the GOK worked out a deal with the Chinese ahead of time, this deal should stick.
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